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UNCLAS SECTION 01 OF 02 VIENNA 002349

SIPDIS

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TREASURY ALSO PASS FEDERAL RESERVE
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E.O. 12958: N/A

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SUBJECT: DOWNWARD REVISION FOR AUSTRIA'S 2005/2006 GROWTH
OUTLOOK

REFS: A) VIENNA 2126; B) VIENNA 1097

Summary

1. Austria's two leading economic institutes have lowered economic growth forecasts for 2005 to 1.8-1.9%, and for 2006 to 1.9-2.3%. The institutes stress again that these figures represent upper limits. The recovery remains export-driven, but there is a possibility that investment and private consumption will pick up in late 2005. The global economic outlook, the German recovery, the recovery of Europe's internal demand, oil prices and the Euro-dollar exchange rate represent downward risks for the 2005/2006 forecasts. The unemployment rate should rise to 4.6% in 2005 and remain at 4.5-4.6% in 2006. Inflation should edge up to 2.5% in 2005, but ease to below 2% in 2006. End Summary.

Growth Rates for 2005 and 2006 Revised Downwards

2. The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) recently presented revised projections for 2005 and 2006. The new figures represent downward changes from previous prognoses (ref B). WIFO reduced 2005 growth estimates from 2.2% to 1.8% and IHS lowered its estimate to 1.9% from 2.1%. Projections for 2006 are now 1.9-2.3%. WIFO Director Karl Aiginger noted that the recovery slowed in the first half of 2005, but the forecasts include projections for faster growth in the second half of 2005. The situation for 2006 is similar, but with greater uncertainties. IHS Director Bernhard Felderer admitted that the IHS's slightly more optimistic outlook is partly contingent on increased growth predictions for Germany. Both institutes look for private consumption to pick up in the second half of 2005, as well as investment spending. WIFO and IHS expect the savings rate to rise from 8.9% of disposable incomes in 2004 to 9.3-9.5% in 2005/2006.

Risks - Exchange Rates, Oil Prices

3. Aiginger and Felderer maintained that Europe's continued anemic internal demand, oil prices and the Euro-dollar exchange rate represented downward risks for the institutes' forecasts. An additional risk is the current slowdown in global economic growth, especially the expected end of the U.S. industrial cycle. According to Felderer, an oil price increase of \$10-15 would reduce economic growth by 0.2 percentage points, and a 10% increase in the Euro exchange rate would reduce growth by 0.4-1.0 points.

Assumptions for Growth Forecasts

4. The institutes based their 2005/2006 forecasts on the following assumptions:
-- U.S. economic growth of 3.3-3.8% in 2005 and 3.0-3.1% in 2006;
-- Euro area growth of 1.5% in 2005 and 1.7-2.0% in 2006;
-- EU-25 growth of 1.6-1.8% in 2005 and 1.8-2.3% in 2006;
-- German growth of 1.0-1.2% in 2005 and 1.3-1.5% in 2006;
-- oil prices of \$50 per barrel in 2005 and \$47 in 2006;
and
-- dollar/Euro exchange rates of 0.80 in 2005 and 0.80-0.85 in 2006.

Bank Forecasts Modest Growth

5. The Austrian National Bank's (ANB) spring forecast of June 2005 projects economic growth of 2.0% in 2005, 2.2%

in 2006 and in 2007, and unemployment rates of 4.5%, 4.4% and 4.3%, respectively. Bank Austria Creditanstalt (BA-CA), Austria's largest commercial bank, also recently revised its growth projection for 2005 downward to 1.5% from 1.7% because of sluggish domestic demand and a weakening global economy since mid-2004. For 2006, BA-CA expects growth of 2.0%.

Inflation Edging Up, Unemployment - A Persistent Problem

16. Inflation should rise 2.4-2.5% in 2005, the highest rate since 2001, due to price increases in housing, tobacco, energy and health services. If oil prices stabilize, inflation could ease below 2% in 2006.

17. Austria is projected to enjoy higher economic growth rates than the Euro-area in 2005/2006, but growth will still be insufficient to improve the unemployment situation. Under the lower WIFO assumption, economic growth will create 27,000 jobs in 2005 and another 20,000 in 2006 and lead to new record employment levels (even though many new jobs will only be part-time jobs). However, the unemployment rate will rise to 4.6% in both years. IHS projects a marginal reduction of the unemployment rate to 4.5% in 2006. According to Felderer, growth of 2.5-2.7% would have a significant impact on the unemployment rate, but economists do not foresee such growth in the near-term (ref A). Labor supply will continue to exceed demand because of additional work permits for foreign labor, a continued influx of foreign labor from the EU-15, rising numbers of illegal works from Central and Eastern Europe, and pension reform, which raised the retirement age.

Comment

18. The latest projections follow a pattern of revising downward growth estimates. The principal impediment to growth remains anemic consumer spending. Private household outlays remain sluggish due to uncertainty about the rising unemployment rate, increased competition from immigration, the effects of pension cuts, and an on-going health care reform. Efforts to reduce the unemployment rate will remain the primary economic policy objective for the GoA.

19. Statistical Annex

Austrian Economic Indicators (percent change from previous year, unless otherwise stated)

	WIFO project. 2005	IHS project. 2005	WIFO project. 2006	IHS project. 2006
Real terms:				
GDP	1.8	1.9	1.9	2.3
Manufacturing	3.0	n/a	3.4	n/a
Private consumption	1.5	1.9	1.8	2.1
Public consumption	0.3	0.4	0.0	0.4
Investment	1.8	2.3	2.7	3.0
Exports of goods	4.2	5.5	5.5	7.0
Imports of goods	2.6	5.1	5.0	6.0
Nominal Euro billion equivalents:				
GDP	244.6	244.6	253.8	254.7
Other indices:				
GDP deflator	2.1	2.0	1.8	1.8
Consumer prices	2.5	2.4	1.9	1.7
Unemployment rate	4.6	4.6	4.6	4.5
Current account (in percent of GDP)	0.6	-0.2	0.6	0.1
Exchange rate for US\$ 1.00 in Euro	0.80	0.80	0.85	0.80

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